Market Update

Evergreen Investments™

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Market Performance

After somewhat lethargic trading activity during June, the equity markets resumed their upward trajectory in July, as the major indexes rose by approximately +8.0% for the month. Though the first several days of trading were weak, the averages rallied off their support levels and climbed to their highest levels of the year based on economic and profit news that were "less bad" than in previous months/quarters. Indeed, the equity gains were significant as the Dow Jones Industrial Average experienced its best July in twenty years and had its best monthly gain since October, 2002. In addition, the S&P 500 Index finished in positive territory for the fifth consecutive month, resulting in its best stretch since 1938! International exposure, particularly in the emerging space, once again provided benefits for diversified portfolios. It should be noted, however, that financial market gains were not simply limited to equities. Fixed income securities also experienced moderate strength as inflation fears ebbed and demand remained solid, particularly for corporate credits. While oil slipped in July, the prices for gold and most other commodities rose as the dollar continued to weaken. See Chart 1 for more details of Market Performance.

U.S. Economy

The economy contracted by a less than expected -1.0% during the second quarter, better than expectations of a -1.5% drop in output. While still signaling recession, the pullback was considerably less damaging than the -6.4% and -5.4% hits to output during the first quarter of this year and the fourth quarter of 2008. Smaller declines in business investment and net exports helped moderate activity for the quarter, as did less inventory liquidation than in the prior six-to-nine months. Personal consumption slid by more than 1%, yet government spending jumped 10%, providing further support for output. The GDP report also included downward revisions over the past two years, indicating the recession was deeper than previously estimated.

The combination of higher government spending, auto production and net exports should enable GDP to finally turn positive for the second half of 2009. To be sure, after the significant struggles in the economy and the financial markets over the past two years, this is welcome news. Yet we remind investors that the crux of the issue remains housing, and with residential investment plunging by almost 30% last quarter and average home prices still down by approximately 17% over the past year, hurdles for sustainable growth remain. Factor in expected increases in the unemployment and saving rates, it is doubtful that the U.S. consumer (responsible for up to 70% of GDP) will be in position to lead the "early cycle" as in prior recoveries. Fortunately, the increases in federal outlays and trade may help cushion the blow to overall output. We remain concerned, however, that fiscal policy, an inventory rebuild, and a weak currency may ultimately serve as tempo-

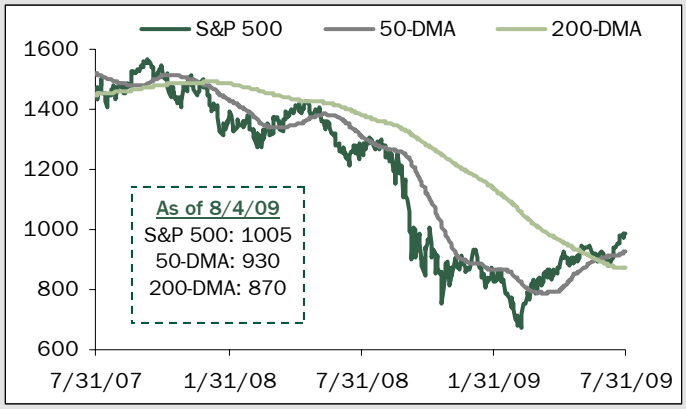
1. Market Performance as of 7/31/09

EQUITIES	7/31/09 LEVEL	JULY TOTAL RETURN	YTD TOTAL RETURN
Dow Jones Industrials	9,171.61	8.8	6.6
S&P 500	987.48	7.6	11.0
NASDAQ	1,978.50	7.8	25.5
Russell 2000	556.71	9.6	12.5
S&P MidCap	628.05	8.7	17.9
Russell 1000 Growth	438.81	7.1	19.5
Russell 1000 Value	502.32	8.2	5.1
MSCI EAFE	1,425.40	9.1	17.8
MSCI (Emerging Markets)	844.02	11.2	51.3
FIXED INCOME	**7/31/09 LEVEL**	**JULY TOTAL RETURN**	**YTD TOTAL RETURN**
10-Year Treasury	3.50	0.5	-8.3
Barclays Aggregate	3.90	1.6	3.5
Barclays Municipal	3.89	1.7	8.2
Barclays Corporate	5.36	4.3	13.0
Barclays High Yield	11.58	6.1	38.4
Barclays Mortgage	4.19	0.8	3.8
Barclays Global ex. US	2.33	2.1	1.5
COMMODITIES & CURRENCIES	**7/31/09 LEVEL**	**JULY TOTAL RETURN**	**YTD TOTAL RETURN**
CRB Index	257.45	3.0	12.2
Crude Oil - WTI	69.45	-0.6	55.7
Gold	955.80	3.1	8.1
Trade Weighted Dollar	78.45	-2.5	-4.5

Source: Factset, Bloomberg, Barclays, Evergreen Investments.
*Total Return includes price appreciation & dividend income for equities.
Past performance is not indicative of future results. It is not possible to invest directly in an index.

rary cushions for the economy, rather than the sustainable catalysts for growth that credit, housing, employment, consumption and investment have proven to be in prior expansions. Consequently, we continue to project a "less spectacular" recovery with GDP growth of approximately 2.5% over the next 12-18 months.

2. S&P 500 vs. Moving Averages



Source: Bloomberg

Equities

In our Midyear Outlook (7.1.09) we highlighted several positive technical developments that occurred within the equity markets over the past several weeks. To summarize, the S&P 500 crossed its 200-day moving average (DMA) in late June and perhaps more important, the index's 50-DMA exceeded its 200-DMA, an event known as a "Golden Cross." We emphasized the significance of this development, indicating that 75% of the time, once this cross had occurred, the market failed to reach a new cycle low. Furthermore, we highlighted the abundance of cash on the sidelines, which now exceeds $3.5 trillion sitting in money market funds, an amount that represents more than one-third the amount of the S&P 500's total market capitalization.

Indeed, these trends helped support the market after the first several days of trading in July, as investors continued taking profits after the significant gains achieved during the first ten weeks of the second quarter. The equity market, as defined by the S&P 500 Index, pulled back 7% from its high on June 12th (945) to its low on July 10th (880). We believe it is important to emphasize that while the index failed to reach the 50% retracement from its lows in March (675) to its highs (945) in June, a level somewhere in the range of 810-840, many of the early cycle sectors did achieve significant retracement, helping the index bounce off its 200-DMA, potentially establishing what we believe to be an all-important "higher low" for the market. Given these considerations, along with the market's strength in the opening days of August, the next critical levels of support for the market reside at the S&P 500's new 50-DMA (930) and then at its new 200-DMA (870). See Chart 2.

The next question for most investors is how much higher can this thing go? To be sure, the market's rapid ascent from the early March lows through the end of July (+45%) has been among its greatest runs in decades. Yet investors need not be reminded of the market's plunge from the all-time high of 1565 in October, 2007, and the ensuing drop of more than 50%. (Good thing we didn't remind you!) We believe it is compelling to regard a 50% retracement of that decline to somewhere near the range of 1100 for the index. But we can't just rely on an abundance of cash and euphoria to propel the market higher, at least on a sustainable basis. Corporate profits still matter, and thankfully, they appear to be coming off their lows as well. Since peaking at a four-quarter run-rate in excess of $90.00 in the second quarter of 2007, operating earnings for the S&P 500 Index, by our lights, are expected to come in around $50.00 for 2009 and $60.00 in 2010. Even if we are conservative by up to 10% in our projections for next year, an index of 1100 would imply a P/E market multiple of 17 times next year's forecast, a level that we would consider rich given the many fundamental challenges still facing the economy.

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John is a Managing Director and Chief Market Analyst for Evergreen Investments. A member of the firm's Investment Strategy Committee, John uses a top-down, macro-economic approach in his analysis of the financial markets. He has been featured in various media outlets, including CNBC, BusinessWeek, CNN-Money, Bloomberg News and The Wall Street Journal.